

Message Text

PAGE 01 STATE 183556

21

ORIGIN EB-07

INFO OCT-01 AF-08 ARA-06 EA-07 EUR-12 NEA-10 IO-13 ISO-00

FEA-01 ERDA-05 AID-05 CEA-01 CIAE-00 CIEP-01 COME-00

DODE-00 FPC-01 H-02 INR-07 INT-05 L-03 NSAE-00 NSC-05

OMB-01 PM-04 USIA-06 SAM-01 OES-06 SP-02 SS-15 STR-04

TRSE-00 ACDA-07 PA-01 PRS-01 /148 R

DRAFTED BY EB/ORF/FSE:WMILAM:KG

APPROVED BY EB/ORF:SBOSWORTH

EB/ORF/FSE:MCREEKMORE

EB/IFD/OMA:RRYAN

EB/ORF/ISM:WWEINGARTEN

COMMERCE:LBLEY

CEA:DCOOPER

TREASURY:ABAKER

FEA:JTREAT

EUR/RPE:ADSSENS (INFO)

----- 003711

P 240034Z JUL 76

FM SECSTATE WASHDC

TO AMEMBASSY ATHENS PRIORITY

USMISSION OECD PARIS PRIORITY

AMEMBASSY BONN PRIORITY

AMEMBASSY ROME PRIORITY

AMEMBASSY BERN PRIORITY

AMEMBASSY STOCKHOLM PRIORITY

AMEMBASSY OSLO PRIORITY

AMEMBASSY COPENHAGEN PRIORITY

AMEMBASSY DUBLIN PRIORITY

AMEMBASSY LUXEMBOURG PRIORITY

AMEMBASSY LONDON PRIORITY

AMEMBASSY THE HAGUE PRIORITY

AMEMBASSY BRUSSELS PRIORITY

AMEMBASSY OTTAWA PRIORITY

AMEMBASSY TOKYO PRIORITY

CONFIDENTIAL

PAGE 02 STATE 183556

AMEMBASSY VIENNA PRIORITY

AMEMBASSY MADRID PRIORITY

AMEMBASSY ANKARA PRIORITY

AMEMBASSY WELLINGTON PRIORITY

C O N F I D E N T I A L STATE 183556

E.O. 11652: GDS

TAGS: ENRG

SUBJECT: IEA: GB BURROWS GROUP MEETING OF JULY 29-30;
US PAPER ON PURCHASING POWER

FOLLOWING IS US PAPER ON PURCHASING POWER OF ENERGY
EXPORT EARNINGS PREPARED FOR BURROWS GROUP MEETING
JULY 29-30. POSTS ARE REQUESTED TO DELIVER PAPER TO
HOST COUNTRY OFFICIAL WHO WILL BE ATTENDING MEETING.
OECD PARIS PLEASE PASS TO IEA SECRETARIAT.

BEGIN TEXT:

AREAS OF COMMON CONCERN FOR CONCENTRATION IN THE
SECOND PHASE

PAPER NO. 7: THE PURCHASING POWER OF ENERGY EXPORT
EARNINGS

INTRODUCTION

1. THE PROTECTION OF UNIT PURCHASING POWER OF THE
EXPORT EARNINGS OF DEVELOPING COUNTRIES (INDEXATION) IS
A MAJOR ISSUE IN THE CIEC. THOUGH ALWAYS COUCHED IN
TERMS OF GENERAL PROTECTION OF PURCHASING POWER OF

THE EXPORT EARNINGS FOR KEY COMMODITIES OF DEVELOPING
COUNTRIES AS A WHOLE, THE G-19 ARGUMENTS AND EVIDENCE
IN THE ENERGY COMMISSION HAVE CONCENTRATED TOTALLY
ON INDEXATION OF THE OIL PRICE. THE OPEC PRODUCERS,
IN PARTICULAR ALGERIA, IRAN, AND IRAQ, HAVE STRONGLY
PUSHED THE CONCEPT, RECEIVING ONLY NOMINAL SUPPORT FROM
CONFIDENTIAL

PAGE 03 STATE 183556

NON-OIL, G-19 MEMBERS OF THE COMMISSION. THIS PAPER
CONCERNS ONLY THE OIL PRICE INDEXATION ISSUE. BY SIMPLE
EXTENSION, HOWEVER, THE DIFFICULTIES OF INDEXATION OF
THE OIL PRICE APPLY TO INDEXATION IN GENERAL.

THE G-19 ARGUMENT

2. THE G-19 ASSERTS THAT
INFLATION IN INDUSTRIAL COUNTRIES IS CONTINUALLY
ELEVATING THE PRICES OF THEIR EXPORTS TO OPEC AT A MORE
RAPID RATE THAN THE OIL PRICE IS RISING. THUS THE
PRICE RECEIVED FOR AN EXPORTED BARREL OF OIL FINANCES
A SMALLER VOLUME OF IMPORTS OVER TIME. THIS ADVERSELY
AFFECTS THE DEVELOPMENT PROCESS OF OIL PRODUCING

COUNTRIES BY NOT ALLOWING THEM TO INCREASE THEIR IMPORTS OF NEEDED GOODS AND SERVICES AS THE DEVELOPMENT PROCESS BROADENS AND DEEPENS. IN PARTICULAR, WITH A DEPLETABLE RESOURCE, VIZ, OIL, EXPORT UNIT PURCHASING POWER MUST BE PROTECTED BECAUSE OF THE NEED TO PROVIDE FOR FUTURE DEVELOPMENT AFTER THE RESOURCE IS DEPLETED.

3. IN 1974 AND 1975, OPEC IMPORT PRICES EXPRESSED IN UNIT VALUES ROSE BY 40 TO 60 , AND IN SOME COUNTRIES BY UP TO 100 . MOREOVER, BETWEEN 1958 AND 1973, THE TERMS OF TRADE OF OPEC COUNTRIES HAVE DETERIORATED; THIS HAS BEEN ONLY PARTIALLY OFFSET BY THE INCREASE IN OIL PRICES AFTER 1973.

4. ANY PLAN TO PROTECT EXPORT UNIT PURCHASING POWER WOULD BE ACCEPTABLE. BUT THE ONLY METHOD THAT APPEARS AVAILABLE IS INDEXATION, I.E., LINKING OIL PRICES TO A PRICE INDEX OF OPEC IMPORTS. INDEXATION SHOULD BE BASED ON AN INDEX OF OPEC IMPORT PRICES, NOT ON PROXIES SUCH AS OECD EXPORTS TO OPEC. THIS INDEX SHOULD BE BASED ON CIF, NOT FOB PRICES, AND DETERMINED BY THE OIL PRODUCERS THEMSELVES.

5. INDEXATION NOTWITHSTANDING, OPEC ASSERTS THAT THE SOVEREIGNTY OF INDIVIDUAL COUNTRIES IN DETERMINING THE PRICE OF THEIR NATURAL RESOURCES CANNOT BE DISPUTED.

CONFIDENTIAL

PAGE 04 STATE 183556

THUS EVEN AN INDEXED OIL PRICE WOULD BE "READJUSTED" PERIODICALLY TO CONFORM WITH REVENUE NEEDS OR THE ASSUMED PRICE OF ALTERNATIVE SOURCES. THE MAIN OPEC OBJECTIVE APPEARS TO BE TO OBTAIN INDUSTRIAL COUNTRY ACQUIESCENCE TO AN INDEXATION SCHEME THAT THEY DEVISE AND MONITOR. IN RETURN THE INDUSTRIAL COUNTRIES WOULD HAVE CERTAINTY ABOUT OIL PRICE LEVELS, FOR THE FEW YEARS BETWEEN EACH READJUSTMENT.

THE INDUSTRIAL COUNTRY POSITION

6. THE MAJOR DIFFICULTIES WITH OIL PRICE INDEXATION ARE ECONOMIC. IT HAS ADVERSE ECONOMIC IMPLICATIONS, NOT ONLY FOR THE INDUSTRIAL COUNTRIES, BUT FOR THE WORLD IN GENERAL. INDEXATION FREEZES THE CURRENT MARKET SITUATION PRODUCING RIGIDITIES AND DISTORTIONS IN PRODUCTION, CONSUMPTION AND INVESTMENT PATTERNS, LEADING TO WORLDWIDE MISALLOCATION OF RESOURCES AND REDUCED ECONOMIC EFFICIENCY. THE OIL PRICE INCREASES OF 1973-74 HAD A SIGNIFICANT IMPACT ON INDUSTRIAL COUNTRY PRICE LEVELS. A RIGID LINK BETWEEN AN INDEXED OIL PRICE AND THE PRICES OF INDUSTRIAL

MANUFACTURED GOODS WOULD TEND TO ACCELERATE THE INFLATIONARY IMPACT OF ANY GIVEN PRICE INCREASE, PARTICULARLY IN INDUSTRIAL COUNTRIES THAT ARE HEAVILY DEPENDENT ON OIL. TO THE EXTENT THAT INFLATIONARY PRESSURES ARE GENERATED WHICH REQUIRE RESTRICTIVE POLICIES IN THE INDUSTRIAL COUNTRIES THEIR GROWTH WOULD BE SLOWED; THIS WOULD INDIRECTLY SLOW THE GROWTH OF DEVELOPING COUNTRIES BY RESTRICTING THE RATE OF GROWTH OF THEIR MAJOR MARKETS. SINCE THE NON-OIL DEVELOPING COUNTRIES ARE SIGNIFICANT IMPORTERS OF OIL AS WELL AS INDUSTRIAL COUNTRY MANUFACTURED GOODS THEY WOULD ALSO BE DIRECTLY AFFECTED BY OIL PRICE INDEXATION.

7. THE INDUSTRIAL COUNTRIES DO NOT ACCEPT THE G-19 CONTENTION THAT THE TERMS OF TRADE OF OIL PRODUCERS HAVE DETERIORATED.

8. MOREOVER, THERE IS LITTLE CHANCE THAT THE TECHNICAL
CONFIDENTIAL

PAGE 05 STATE 183556

DIFFICULTIES OF CONSTRUCTING A VALID INDEX COULD BE OVERCOME TO THE MUTUAL SATISFACTION OF BOTH SIDES. (THESE DIFFICULTIES ARE LISTED BELOW).

ASCERTAINABLE FACTS

TERMS OF TRADE

9. THE EVIDENCE ON OPEC TERMS OF TRADE IS AMBIGUOUS, AS ARE TERMS OF TRADE FOR ANY GROUP OF COUNTRIES OR ANY COMMODITY. THE CONCLUSIONS DEPEND ON THE METHODOLOGY USED, PARTICULARLY THE CHOICE OF A BASE PERIOD AND THE LENGTH OF THE TIME SERIES USED. IN FACT, ANY CONCLUSION ON OPEC TERMS OF TRADE IS SUSPECT SINCE IMPORT PRICE TRENDS ARE MEASURED BY UNIT VALUE INDICES, GENERALLY ACKNOWLEDGED AS HIGHLY UNRELIABLE, AND INCLUDE TRANSPORT AND INSURANCE COSTS.

10. IF 1958 IS USED AS A BASE YEAR, AS OPEC DID IN THE G-19 PAPER ON HISTORIC TERMS OF TRADE PATTERNS, DETERIORATION CAN BE SHOWN BETWEEN 1958 AND 1973. USING 1960 HOWEVER, THE UNCTAD SECRETARIAT FIGURES INDICATE AN IMPROVEMENT BETWEEN 1960 AND 1973.

11. WHAT IS MUCH LESS AMBIGUOUS, HOWEVER, IS THAT FROM 1973 OPEC'S TERMS OF TRADE HAVE IMPROVED SUBSTANTIALLY. THE UNCTAD FIGURES SHOW IMPROVEMENT OF 135 BETWEEN 1973 AND 1975.

12. THE OPEC ARGUMENT THAT THEIR HISTORIC TERMS OF TRADE HAVE DETERIORATED IS NOT AN OBJECTIVE OR A

COMPLETE ANALYSIS. IT ARBITRARILY CHOOSES A BASE YEAR (1958) WHEN OIL PRICES WERE AT A CYCLICAL PEAK. IT DISTORTS THE IMPORT/EXPORT PRICE COMPARISON BY USING DOLLAR EXPORT PRICES AND LOCAL CURRENCY IMPORT PRICES (WHERE A SUBSTANTIAL DEVALUATION OCCURRED.) IT SERIOUSLY MISREPRESENTS THE DATA WITH QUESTIONABLE STATISTICAL PROCEDURES. CHANGING THE BASE YEAR AND BRINGING THE STATISTICAL PROCEDURES INTO CONFORMITY WITH STANDARD PRACTICE DRASTICALLY ALTERS THE OPEC RESULTS.
CONFIDENTIAL

PAGE 06 STATE 183556

RECENT IMPORT PRICE TRENDS

13. OPEC'S FIGURES FOR RECENT IMPORT PRICE TRENDS ARE SERIOUSLY EXAGGERATED. OECD EXPORT PRICE INDICES (USING UNIT VALUES) AND RECENT US STUDIES INDICATE A MUCH LOWER RATE OF PRICE INCREASE FOR INDUSTRIAL COUNTRY EXPORTS TO OPEC. A US STUDY COVERING US TRADE WITH OPEC IN 1974 AND 1975 IS BASED ON TRANSACTION PRICES; IT ADJUSTS FOR CHANGES IN THE COMMODITY COMPOSITION OF TRADE. THIS STUDY INDICATES US EXPORT PRICES TO OPEC ROSE BY 13.1 BETWEEN THE BEGINING OF 1974 AND APRIL 1975. AGGREGATING THIS INDEX WITH COMPARABLE EXPORT PRICE INDICES PUBLISHED BY JAPAN AND WEST GERMANY (WEIGHTED BY THE AMOUNT OF TRADE OF EACH WITH OPEC) INDICATES THAT EXPORT PRICES OF THE THREE COUNTRIES TO OPEC ROSE BY 8.4 PER CENT IN 1974 AND 1975.

14. IT IS CLEAR THAT A GREAT PART OF THE IMPORT PRICE TRENDS CITED BY OPEC RESULTS FROM DOMESTIC FACTORS IN THOSE COUNTRIES RESULTING FROM THEIR RAPID RISE IN INCOMES; THEY ARE NOT THE RESULT OF INTRINSIC INFLATION IN EXPORT COSTS. THESE COUNTRIES WITH VAST INCREASES IN INCOMES HAVE SERIOUSLY UPGRADED THE QUALITY OF GOODS THEY IMPORT, PAYING HIGHER PRICES. THEY HAVE ALSO INCREASED THE QUANTITY OF IMPORTED GOODS SERIOUSLY STRAINING THEIR RECEIVING AND DISTRIBUTING INFRASTRUCTURE. THIS HAS RESULTED IN ESCALATING DEMURRAGE AND OTHER TRANSPORT CHARGES INCLUDING PREMIUM PAYMENTS FOR RAPID DELIVERY.

TECHNICAL ASPECTS

15. AT THIS POINT THERE IS A VAST ARRAY OF TECHNICAL PROBLEMS THAT COULD POSSIBLY BE SOLVED FROM A TECHNICAL POINT OF VIEW BUT WHICH WOULD PRESENT PERHAPS INSURMOUNTABLE PROBLEMS IN A POLITICAL CONTEXT. A SIMPLE LISTING WOULD BE.

-- LACK OF SUFFICIENT AND ACCURATE DATA IN OPEC COUNTRIES.

CONFIDENTIAL

PAGE 07 STATE 183556

-- USE OF UNIT VALUE INDICES TO MEASURE OECD EXPORT PRICES (IF THESE WOULD BE USED AS A PROXY).

-- SELECTION OF A BASE YEAR.

-- AGGREGATION OF INDEX.

-- LENGTH OF TIME SERIES.

-- USE OF AN OVERALL INDEX WOULD MEAN INDIVIDUAL COUNTRY TERMS OF TRADE WOULD MOVE DIFFERENTIALLY.

-- A MORE SPECIFIC INDEX FOR INDIVIDUAL COUNTRIES OR GROUPS IS IMPOSSIBLE AS IT IMPLIES DIFFERENT PRICES FOR OIL.

IMPONDERABLES

INFLATION

16. ONE MAJOR CONCERN OF OPEC HAS BEEN THE HIGH RATES OF DOMESTIC INFLATION IN THE INDUSTRIAL COUNTRIES WHICH WERE SERIOUSLY EXACERBATED BY THE OIL PRICE INCREASES. THESE RATES SLOWED DRAMATICALLY IN 1975 AS A RESULT OF THE RECESSION. HOWEVER, IT IS NOT LIKELY THAT OPEC WOULD REDUCE ITS PRESSURE FOR OIL PRICE INDEXATION IF INDUSTRIAL COUNTRY GOVERNMENTS MAINTAIN LOWER RATES OF INFLATION IN THE RECOVERY PERIOD THAT IS NOW UNDERWAY, THOUGH ONE MAJOR OPEC ARGUMENT FOR INDEXATION WILL BE UNDERCUT. ONE FACTOR WHICH WILL DETERMINE INDUSTRIAL COUNTRY INFLATIONARY PRESSURES IS THE COURSE OF THE OIL PRICE OVER THE NEXT FEW YEARS.

POLITICAL SUPPORT OF NON-OIL LDC'S

17. IT IS QUITE CLEAR THAT INDEXATION OF THE OIL PRICE IS NOT IN THE INTEREST OF NON-OIL LDC'S. MANY OF THEM MAY HOPE THAT SUCCESS BY OPEC IN ACHIEVING INDEXATION COULD LEAD TO SIMILAR SCHEMES FOR THEIR KEY COMMODITY EXPORTS. YET THE SILENCE OF NON-OIL LDC'S AT THE ENERGY COMMISSION MEETINGS IN WHICH OIL PRICE INDEXATION HAS

CONFIDENTIAL

PAGE 08 STATE 183556

BEEN DISCUSSED IS A CLEAR INDICATION THAT THEY ARE DUBIOUS THAT THE CONCEPT CAN BE EXTENDED TO THEM. FOR MANY COMMODITY PRODUCERS SUCH A SCHEME MIGHT NOT BE IN THEIR INTERESTS DURING AN UPSWING IN THE ECONOMIC CYCLE .

SAUDI ARABIA

18. IN BILATERAL CONTACTS SAUDI ARABIAN REPRESENTATIVES HAVE INDICATED THAT INDEXATION OF THE OIL PRICE IS PROBABLY NOT IN SAUDI INTERESTS. IT WOULD INTRODUCE A AUTOMATIC MECHANISM TO DETERMINE OIL PRICES AND THUS REDUCE SAUDI INFLUENCE WITHIN OPEC. AT PRESENT THE SAUDIS HOLD THE KEY TO OPEC PRICING POLICIES. THE FUTURE EVOLUTION OF THE SAUDI ATTITUDE ON INDEXATION COULD BE AN IMPORTANT FACTOR IN OPEC'S ATTITUDE TOWARD INDEXATION.

CONCLUSIONS

-- OIL PRICE INDEXATION IS NOT IN THE INTERESTS OF CONSUMING COUNTRIES AND PARTICULAR THE NON-OIL LDCS. IT WOULD HAVE A DELETERIOUS EFFECT ON THE WORLD ECONOMY, HEIGHTENING INFLATIONARY PRESSURES, AND REDUCING WORLD ECONOMIC EFFICIENCY. ITS AFFECT ON GROWTH COULD BE ADVERSE, WHICH WOULD EXACERBATE TENSIONS IN THE THIRD WORLD AND INCREASE DEMANDS ON INDUSTRIAL COUNTRIES FOR RESOURCE TRANSFERS.

-- THE G-19 IS PRESSING FOR OIL PRICE INDEXATION IN THE CONTEXT OF A GENERAL INDEXATION SCHEME FOR KEY LDC COMMODITIES. AT BEST, OIL PRICE INDEXATION IS IN THE INTEREST OF OIL EXPORTERS ONLY, AS LONG AS THEIR IMPORT COSTS DO NOT DECLINE.

-- THE ARGUMENTS PUT FORWARD BY THE G-19 FOR OIL PRICE INDEXATION HAVE LITTLE MERIT. THE LONG RANGE TERMS OF TRADE OF OIL PRODUCING NATIONS HAVE IMPROVED SUBSTANTIALLY, IF THE LAST 2 1/2 YEARS ARE INCLUDED. THE TRENDS OPEC CITES FOR THEIR IMPORT PRICES IN 1974 AND 1975 ARE CONSIDERABLY EXAGGERATED.

CONFIDENTIAL

PAGE 09 STATE 183556

-- THERE IS EVIDENCE THAT OPEC DOES NOT FAVOR AN AGREED INDEXATION FORMULA BETWEEN PRODUCER AND CONSUMERS, BUT INSTEAD IT WANTS ONLY INDUSTRIAL COUNTRY ACQUIESCENCE OR ENDORSEMENT OF WHATEVER INDEXATION SCHEME THEY CAN DEVISE OR MAINTAIN REAL PRICES.

-- OPEC WILL CERTAINLY RETAIN THE POWER TO MOVE PRICES AS THEY WISH, AND EVEN WITH INDEXATION WILL QUOTE READJUST END QUOTE PRICES UPWARD AS THEIR PERCEIVED NEEDS REQUIRE. END OF TEXT. ROBINSON

CONFIDENTIAL

<< END OF DOCUMENT >>

Message Attributes

Automatic Decaptioning: X
Capture Date: 15 SEP 1999
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: TEXT, ENERGY, PETROLEUM, PRICE INDEXES, MEETINGS
Control Number: n/a
Copy: SINGLE
Draft Date: 24 JUL 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: KelleyW0
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976STATE183556
Document Source: ADS
Document Unique ID: 00
Drafter: EB/ORF/FSE:WMILAM:KG
Enclosure: n/a
Executive Order: 11652 GDS
Errors: n/a
Film Number: D760285-0685
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t197607109/baaaepmj.tel
Line Count: 377
Locator: TEXT ON-LINE, TEXT ON MICROFILM
Office: ORIGIN EB
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: KelleyW0
Review Comment: n/a
Review Content Flags:
Review Date: 26 MAR 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <26 MAR 2004 by greeneet>; APPROVED <05 AUG 2004 by KelleyW0>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: IEA: GB BURROWS GROUP MEETING OF JULY 29-30;
TAGS: ENRG, GR, FR, OPEC
To: ATHENS
OECD PARIS
BONN
ROME
BERN
STOCKHOLM

OSLO
COPENHAGEN
DUBLIN
LUXEMBOURG
LONDON
THE HAGUE
BRUSSELS
OTTAWA
TOKYO
VIENNA
MADRID
ANKARA
WELLINGTON

Type: TE

Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006